COMMONWEALTH OF MASSACHUSETTS

DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY

Boston Edison Company	)	D.T.E. 99-107

REPLY BRIEF OF BOSTON EDISON COMPANY

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I. INTRODUCTION

In this reply brief, Boston Edison Company ("Boston Edison" or the "Company") responds to the Attorney General's Reply Brief on the one unresolved issue in this proceeding.[1] That remaining issue concerns the appropriate treatment of revenues and costs associated with Boston Edison's wholesale power supply contracts consistent with the agreements underlying Boston Edison's Restructuring Settlement Agreement (Exh. BEC-18) (the "Restructuring Settlement"), which was approved by the Department of Telecommunications and Energy (the "Department") in D.P.U./D.T.E. 96-23. The Restructuring Settlement explicitly provides that those contracts are to be "revenue credited." The Attorney General appears willing to accept half of that bargain by accepting all of the revenues from those contracts as a credit; however, he is unwilling to accept the costs necessary to serve those contracts. This is neither a fair nor a legally tenable application of the principle of revenue crediting, and the Attorney General's arguments should be rejected.

[1] On September 6, 2000, the Division of Energy Resources (the "DOER") also filed a one-page letter in this proceeding stating that DOER supports the Attorney General's position.

The Attorney General has very narrowly sought to focus on the issue of the manner in which the Company has proposed to reconcile the costs incurred to serve its remaining contractual obligations to wholesale customers and has chosen to overlook the more central question of what was included in the Restructuring Settlement. The Company believes that the proposed method of accounting for wholesale revenues and costs employed in this filing is fully appropriate and consistent with the provisions of the Restructuring Settlement. It is also exactly the same as in each previous restructuring-related filing with the Department and as thoroughly described and explained in sworn testimony filed with the Federal Energy Regulatory Commission ("FERC").

However, in the final analysis, the Company is far less concerned with the particular account in which costs are recovered than with the fact that the costs <u>are</u> properly recovered.[2] The point is simply that the Company cannot be required to credit all revenues from wholesale sales to retail customers, while being denied recovery of its costs to serve these customers. This is the essence of the revenue-credit methodology as explained in the Company's Initial Brief (Company Initial Brief at 10-14) and the Restructuring Settlement is unambiguous that that was the agreed treatment of the Company's FERC-regulated wholesale contracts (Restructuring Settlement at 251).

In his reply brief, the Attorney General contends that the Company has not provided "any evidence" that $35.4 million has been credited to the Company's distribution rates or that retail customers benefit or share in the profits of wholesale sales (Attorney General Reply Brief at 3, n.1, and at 4, n.4). As described below, the Attorney

[2] It is for this reason that the Company in its Initial Brief suggested the alternative mechanism of recovery through the transition charge (Company Initial Brief at 19, n.13).

General's assertions are without merit. The benefits of the wholesale revenue credit to retail customers are established by uncontradicted record evidence. The Attorney General also asserts that the Company's FERC filing in docket ER99-35-000, which sought to modify the fuel adjustment clause of the Company's wholesale requirements contracts, somehow contradicts the Company's revenue-credit method of accounting for wholesale sales in the Restructuring Settlement (Attorney General Reply Brief at 2, n.1, and at 4-5). The Attorney General's contention is incorrect. To the contrary, the Company's FERC filing sought to preserve the benefits that would be realized by retail customers through the revenue-credit method.

Finally, the Attorney General attempts to distinguish "existing," as compared to "future" stranded costs, contending that retail customers should not be responsible for the "going forward costs" associated with the Company's wholesale contracts (Attorney General Reply Brief at 3-4). This argument is off the mark and ignores both the "existing" nature of those wholesale contracts and the fact that both the costs and revenues are "going forward" in nature. Assuming that the Attorney General's reference to "existing" stranded costs is the above-market generating costs recovered under the Restructuring Settlement, there appears to be no dispute that 100 percent of these stranded costs are recovered from retail customers. Given that retail customers paid for stranded costs, it was appropriate that wholesale net revenues (netting some $29.5 million after costs in 1998 alone) be used to mitigate these stranded costs (<u>see</u> Company Initial Brief at 19).

Accordingly, the Company requests the Department to approve the recovery of its wholesale supply costs in accordance with the revenue-crediting mechanism contained in the filing as described in the Company's briefs.

II. ARGUMENT

A. The Restructuring Settlement and the Record in this Proceeding Support the Revenue-Credit Treatment of the Company's Wholesale Contracts.

The remaining contested issue in this proceeding centers on the treatment of the Company's wholesale contracts in the Restructuring Settlement. The Company contends that the Restructuring Settlement is premised upon a revenue-credit treatment and points to the explicit words that so state in a footnote to one of the schedules. The Company also points to its unrebutted evidence in this proceeding, as well as its filings and testimony in numerous other proceedings to establish the manner in which this revenue crediting would be accomplished. By contrast, the Attorney General points to no record evidence and provides no coherent explanation of his apparent contention that the Restructuring Settlement was based on something other than a revenue-credit treatment of wholesale contracts. What this "other" agreement may have been, the Attorney General does not say; although in his reply brief he concedes that there must have been some kind of agreement,[3] if only to explain the otherwise inexplicable fact that the Restructuring Settlement clearly assigns 100 percent of stranded costs to retail customers.

[3] "Although retail distribution rates may reflect some level of compensation for this burden…" (Attorney General Reply Brief at 3).

There is no other apparent compensation from the wholesale customers to retail customers other than the wholesale contract revenues.[4]

Contrary to the unsupported assertion of the Attorney General, the record in this case establishes unrebutted evidentiary support for the Company's position that it properly has credited the revenues associated with its wholesale electricity sales by crediting $35.4 million to the Company's distribution revenue requirement and an additional $14.0 million to the costs of standard offer and default service in 1998. Distribution rates set in the Restructuring Settlement take into account a $35.4 million revenue credit, which represented the annual level of demand charges historically collected from wholesale customers (Exh. DTE-1-44; Exh. DTE-3-5).[5] Notably, the Attorney General presents no evidence that would contradict the Company's record evidence supporting the existence and basis of this $35.4 million revenue-credit (nor does he describe a plausible alternative to the Company's position). Moreover, contrary to the assertions of the Attorney General, this proposition is fully supported by the evidence presented in the wholesale-contract proceeding at FERC:

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4 As will be discussed further in Section II.C, below, the Attorney General unsuccessfully attempts to draw a distinction between existing stranded costs and going-forward stranded costs. This argument has two flaws. First, the contracts themselves, with all attendant rights and obligations, were in existence as binding obligations as of the relevant date of restructuring. Moreover, if one accepts that there is to be a crediting of revenues, which is a "going forward" proposition, one cannot at the same time disclaim the contractual costs, which are necessary in order to receive the revenues.

5 The $35.4 million wholesale revenues at the time of the Restructuring Settlement is taken from the 1996 FERC Form 1 (Exh. DTE-3-5). Rather than showing the wholesale revenues as a credit to the Transition Charge, the parties agreed that the wholesale revenues should be credited to the distribution rates (Exh. DTE-1-44).

> **Q. Do the wholesale contract revenues reduce the stranded cost paid by retail customers?**
>
> A. Yes, indirectly. Retail customers pay all stranded costs through their access charge [transition charge]. However, the retail customers are credited with the revenues from the wholesale contract sales in recognition of the wholesale customers' share of the Company's total stranded cost liability. Wholesale fuel revenues are credited to the retail power supply. Wholesale non-fuel revenues are credited to the retail distribution rate. <u>The applicable non-fuel wholesale revenue credit was $35.4 million or 0.3¢ per kWh and was applied to the retail distribution rates</u>.

<u>Direct Testimony of Geoffrey O. Lubbock</u> at 14 [ER99-35-000] (emphasis added).[6]

The Attorney General is also wrong in stating that the Company's filing in the FERC proceeding conflicts with the fact that Boston Edison's wholesale sales of electrical generation were intended to provide benefits for retail customers (Attorney General Reply Brief at 2-3, n.1). The last remaining wholesale contracts represented less than 7 percent of the total generation sales of the Company (Exh. BEC-8, page 8 of 13, line 20; Exh. BEC-8, page 9 of 13, line 24) and those contracts are expiring over the next few years. Notwithstanding the fact that certain of these wholesale contracts were with longstanding all- or partial-requirements customers of the Company, it should be noted that each of the wholesale contracts in question were products of a recent vintage (<u>see Boston Edison Filing Letter</u>, at 2 [ER99-35-000] (attached to Attorney General Reply Brief)). Each of the contracts at issue in the ER99-35-000 docket dated from the early to mid-1990's and was for a term of years reflecting the fact that wholesale customers were by that date exercising their bargaining leverage to be able to shop competitively for

6 Attachment A, hereto, is a full copy of the direct, sworn testimony of Geoffrey O. Lubbock in ER98-35-000. The case was cited by the Attorney General who attached the cover letter for that FERC filing. The evidence submitted to FERC is fully supportive of the Company's position in this proceeding.

power. Moreover, the Company's two other wholesale contracts, with the MBTA and MassPort, represented situations involving former retail customers who posed the potential threat of terminating generation service from the Company, which would eliminate contribution toward the fixed costs of the system that had previously served them. See, e.g., Boston Edison Company, D.P.U. 94-1A (1994); Massachusetts Electric Company, D.P.U. 95-40, at 67 (1995).

Not only did Mr. Lubbock establish in the FERC proceeding (as he did in this case) that retail customers benefit from the wholesale sales, but when the Company was relieved of its obligation to provide generation to its retail customers, it also took steps to withdraw from providing wholesale service (Tr. VI, at 699-700 [D.T.E. 99-19]; Direct Testimony of Geoffrey O. Lubbock at 6 [ER99-35-000]). All that remains is the fulfillment of the pre-existing contractual obligations to a handful of wholesale customers.[7]

Similarly, the Attorney General's contention that there is no evidence of retail customer benefits or the sharing of the Company's wholesale contract-related profits with retail customers is factually erroneous. As explained in the Company's Initial Brief,

[7] The Attorney General argues that the Company has, first, misstated the true nature of its wholesale business (Attorney General Reply Brief at 2-3, n.1) and, second, somehow mischaracterized the nature of these contracts in light of the Department's 1983 Order in D.P.U. 1350 (id. at 4, n.6). Whatever the historical reasons that may underlie the existence of the Company's wholesale business, by the 1990's those reasons had changed, and by the time of the Restructuring Settlement they had ceased to exist altogether. When the Company agreed as a part of the Restructuring Settlement to sell all of its generating assets in order to mitigate stranded costs, the Company agreed to give up the ongoing wholesale business that was served using those generating assets and the only remaining "business" was the orderly termination of those contracts, while seeking to retain, for the benefit of retail customers, as much of the wholesale revenues as possible as an offset to the retail revenue requirement. In that sense, the Company's remaining wholesale contracts are exactly like those addressed in D.P.U. 1350 (i.e., serving to benefit retail customers by reducing the overall retail revenue requirement), and the Company's efforts at FERC were and are devoted entirely to seeking to preserve that benefit for retail customers.

wholesale operations do not produce a loss for retail customers today (Company Initial Brief at 19). Total revenues from wholesale sales for the last ten months of 1998 were almost $45 million (Exh. DTE-1-43; RR-AG-9) in comparison to the cost of supply claimed by the Attorney General of $33.1 million (Attorney General Initial Brief at 8, n.6). The Attorney General's Reply Brief fails to rebut, or even to address, this analysis, which demonstrates that retail customers, in fact, benefited for the last ten months of 1998 by the wholesale demand revenue credit of $29.5 million ($35.4 million * 10/12) and the wholesale fuel revenue credit of $14.0 million (Attorney General Initial Brief at 8, n.6), greatly exceeding the Attorney General's calculation of "Wholesale Allocation of Power Costs."

The Attorney General attempts to dismiss the Restructuring Settlement's explicit reference to the fact that the Company's wholesale contracts are "revenue credited" to the distribution charge by suggesting that the referenced schedule is an "unintended vestige" of the use of the Massachusetts Electric/NEES restructuring settlement schedules as a "model" for the Boston Edison settlement documents (Attorney General Reply Brief at 3, n.4). This assertion is without merit.

A comparison of New England Power's ("NEP") Schedule 1, page 11 of 16 (provided in Attachment B, hereto) with Boston Edison's Attachment 3, Schedule 1, page 11 of 14 (page 251 of the Restructuring Settlement, also included as part of Attachment B) demonstrates that Boston Edison's schedule properly describes its own relevant information concerning unit sale power contracts, and is not simply an overlooked reproduction of the Massachusetts Electric/NEES restructuring settlement schedules. Boston Edison agrees with the Attorney General that the NEP schedules served as a model for the Boston Edison format, and it is for this very reason that the notations on page 251 are particularly significant.

The corresponding page on NEP's schedule is populated with data showing estimates of annual utility unit sales from four unit sales power contracts (Attachment B, hereto). Because Boston Edison's Restructuring Settlement handled wholesale sales through a revenue-crediting mechanism, it was important to include the schedule, with no data, but with the clear explanation of why the information was <u>not</u> included.[8] The notation is not "wholly uninformative" (Attorney General Reply Brief at 3, n.4), but was intended to avoid any ambiguity that could later be claimed by omitting the schedule in its entirety or including the schedule without estimated data. Accordingly, the information contained in Boston Edison's schedule is not a "unintended vestige," but rather identifies the knowing and willful intention of the parties concerning the treatment of Boston Edison's wholesale contracts.

B. Boston Edison's FERC Filing in Docket ER99-35-000 Does Not Contradict the Company's Revenue-Credit Method Concerning Its Wholesale Contracts.

The Attorney General asserts that the Company's FERC filing in ER99-35-000, somehow "contradicts" the Company's Revenue Credit method concerning its wholesale contracts (Attorney General Reply Brief at 2, n.1, and 4-5). In reality, the Company's FERC filing sought to protect the interests of its retail customers.[9] Nothing in the

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8 The note at the bottom of the schedule that is not included in NEP's schedule, states: "Note: FERC wholesale contracts are revenue credited to the Distribution Charge" (Restructuring Settlement at 251).

9 On October 2, 1998, the Company filed to modify the fuel adjustment clause in four wholesale requirements contracts because the fuel clauses would no longer work as originally intended in the restructured environment (the Company had divested all of its fossil generation assets and was in

(footnote continued)

Company's FERC filing contradicts the use of a revenue-credit method concerning its wholesale contracts in the calculation of the Company's Transition Charge.

Indeed, the Company's FERC filing supports the Company's position in this case. The Company's filing letter, attached to the Reply Brief of the Attorney General, states:

> In the calculation of retail stranded cost recovery, the [Department] has taken account of the Company's six wholesale requirements contracts by assuring that the retail customers are responsible for 100% of the Company's stranded costs and by using the revenues under the wholesale contracts as a credit to retail stranded cost recovery. Thus, a depletion or loss of wholesale contract revenues would reduce BECo's stranded cost recovery [citation to exhibit omitted].
>
> ***
>
> By maintaining the economic value of the contracts, the wholesale customers will make a contribution during the remaining term of their existing contracts to the Company's above-market stranded costs at least during the remaining terms of their existing contracts [citation to exhibit omitted].

Boston Edison Filing Letter at 8, n.1; and at 6-7. The Company's FERC filing was fully consistent with the Company's revenue-credit method in its Transition Charge calculation. The filing served the critically important function of seeking to preserve the economic value of the contracts so that the wholesale customers would continue to make a fair contribution to the Company's retail customer stranded costs. Notably, the Attorney General failed to intervene or file any opposition in the FERC proceeding, despite his apparent contrary interpretation of the direct assertions made by the Company

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(footnote continued)

the process of divesting its Pilgrim Station nuclear asset) because the Company would be serving its load chiefly through power purchases in the NEPOOL bilateral markets and in the NEPOOL spot markets (Boston Edison Filing Letter at 4 [ER99-35-000]) (attached to the Attorney General's Reply Brief).

concerning the application of a revenue-crediting method used in the calculation of the Transition Charge. Nothing in the FERC's decision denying the Company's request to modify its wholesale fuel adjustment clause conflicts with the underlying intention of the Company's filing to preserve the wholesale customers' contribution to retail costs. Boston Edison Company, 86 FERC ¶ 61,154 (1999); Rehearing Denied, 87 FERC ¶ 61,058 (1999).[10]

C. The Restructuring Settlement's Revenue-Credit Method Makes No Distinction Between "Existing" and "Future" Stranded Costs.

It is undisputed that the Restructuring Settlement places full responsibility for stranded costs on retail customers, and the Attorney General concedes that retail distribution rates may reflect "some level" of compensation from wholesale customers for retail customers bearing that responsibility (Attorney General Reply Brief at 3). Nonetheless, the Attorney General argues that the Restructuring Settlement did not intend that retail customers be responsible for the Company's "going forward" stranded costs (id. at 4). This contention is without merit because it reflects a meaningless and

[10] FERC's decision was based entirely on its conclusion that the Company did not meet the Mobile-Sierra standard for contract modification. Boston Edison Company, 86 FERC ¶ 61,154 (1999). Although FERC denied the requested rate-schedule modification with respect to one wholesale customer (Concord), FERC at the same time approved contract modifications that had been agreed to with three other customers (Braintree, Reading and Wellesley). Id. Moreover, the Company had previously reached agreement, or no modification was required, in the case of the Company's other two wholesale customers (MBTA and MassPort). See Boston Edison Filing Letter at 2; Boston Edison Company, ER99-54-000, 85 FERC ¶ 61,305 (1998). Finally, with respect to Concord, an appeal was subsequently taken to the U.S. Court of Appeals for the DC Circuit (Boston Edison Company v. FERC, Case No. 99-1219) which remains pending, although the Company and Concord have most recently reported to the Court that a settlement in principle had been reached. Thus, notwithstanding the implications of the Attorney General's argument regarding the Company's filing at FERC, it is the Company's view that that effort has ultimately been successful in protecting the revenue credit from these wholesale contracts for the benefit of the Company's retail customers.

unprincipled distinction concerning the nature of stranded costs and the revenue-credit method adopted in the Restructuring Settlement.

Having acknowledged that some form of revenue crediting has indeed been incorporated into the Restructuring Settlement, the Attorney General seeks to draw a distinction between "existing" stranded costs and "going forward" stranded costs. No such distinction exists. Section I.B.1(c) of the Restructuring Settlement indicates that the Company's Access Charge is "designed to recover on a fully reconciling basis <u>all</u> of Boston Edison's stranded costs" [emphasis added]. Consistent with the revenue-credit mechanism, retail customers are responsible for all generation-related costs because they are receiving all of the benefits of wholesale sales revenues. As described in the Company's Initial Brief, because the revenue-credit approach was agreed to by the parties to the Restructuring Settlement, the only issue is to ensure that wholesale revenues are properly credited to retail customers. The bulk of wholesale revenues ($35.4 million in demand revenues) are revenue credited to the Company's base distribution rates (Exh. DTE-1-44; Exh. DTE-3-5). Wholesale energy revenues are revenue credited to the Company's standard offer/default service (Exh. DTE-1-54, Response to Information Request DTE-1-12 [D.T.E. 98-111]). Accordingly, the Attorney General fails to provide any principled basis or record evidence to suggest that retail customers are responsible only for "existing" stranded costs, and not "going forward" stranded costs associated with the Company's wholesale contracts.

In essence, the revenue-credit approach mitigates stranded costs by reducing the cost burden on retail customers. The Company was able to maximize the value of its divested generation assets (which had also been used to supply wholesale customers) by divesting them in toto. All of the net proceeds of the sale of assets inure to the benefit of retail customers since retail customers are, under the Restructuring Settlement, responsible for all stranded costs (Restructuring Settlement, § I.B.1.(c), at 25). However, in order to accomplish this maximization of divestiture proceeds and to continue to provide the benefits of the wholesale revenues to retail customers, it is necessary for the Company to continue to procure power to meet its remaining wholesale contract obligations. As established by this record, the totality of these transactions provides significant benefits to retail customers and maximizes the mitigation of stranded costs.[11] Contrary to the Attorney General's assertion, these stranded costs are indeed "existing" in nature and the expenditures at issue simply act to mitigate those stranded costs.

The only legitimate question is the precise mechanism by which the costs incurred to generate the wholesale revenue credits for retail customers are collected. As indicated in the Company's Initial Brief, the Restructuring Settlement is admittedly silent as to the mechanism for the reconciliation of the costs. However, the Attorney General elevates form over substance by basing a $19 million shareholder disallowance (for only ten months of 1998) on the Restructuring Settlement's silence on the reconciliation mechanism. Boston Edison has reasonably proposed to reconcile the costs of wholesale sales through standard offer and default service because it is also required to purchase power to discharge its ongoing obligations with respect to these services (Company

[11] The maximization of the mitigation of stranded costs is never a cost-free undertaking. For example, the sale of generation assets or the securitization of transition costs often entails significant transaction costs. See Boston Edison Company, D.T.E. 98-119, at 64-65 (1999); Boston Edison Company, D.T.E. 98-118, at 21-22, n.21 (1999). Similarly, in this case, the mitigation represented by the wholesale credits flowing back to retail customers requires the expenditure of power-purchase costs to serve those customers.

Initial Brief at 18-19). However, as stated in footnote 13 of the Initial Brief, the Company would have no objection to accounting for wholesale costs through the reconciliation of the transition charge (id. at 19).

III. CONCLUSION

As described in the Company's Initial Brief, the Attorney General's position on wholesale costs would create a regulatory abyss in which millions of dollars would permanently disappear and be borne by shareholders. It would be totally inappropriate for customers to receive the benefit of wholesale sales without paying the related costs of supply. The appropriate revenue-credit methodology is a long-established ratemaking model, and an attempt to create a mismatch of revenues and costs, as proposed by the Attorney General, is unfair and illogical. The record in this case is fully supportive of the Company's position, and the Company's filing in the FERC proceeding cited by the Attorney General is consistent with Boston Edison's arguments.

Accordingly, for all of the reasons stated above and in the Company's Initial Brief, the Company respectfully requests the Department to approve the recovery of its wholesale generation costs in accordance with the revenue-crediting mechanism described by the Company.

Respectfully submitted,

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